

Financing Case Studies: California Pollution Control Financing Authority

Reneé Webster-Hawkins

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CALIFORNIA POLLUTION CONTROL FINANCING AUTHORITY



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Tax-Exempt Financing for Private Entities

TAX EXEMPT FINANCING OVERVIEW

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- Tax-exempt bonds are typically issued by a state or local government entity or a municipality
- With the use of a conduit issuer such as CPCFA, not-for profit organizations, investor-owned utilities and certain private entities may issue tax-exempt bonds
- There can be many advantages to using tax-exempt financing
 - ✓ Cheaper than typical financing
 - ✓ Tax-exempt bond issues generally exceed \$2.5 million
 - ✓ Maturity of the bonds can be up to 120% of the project life

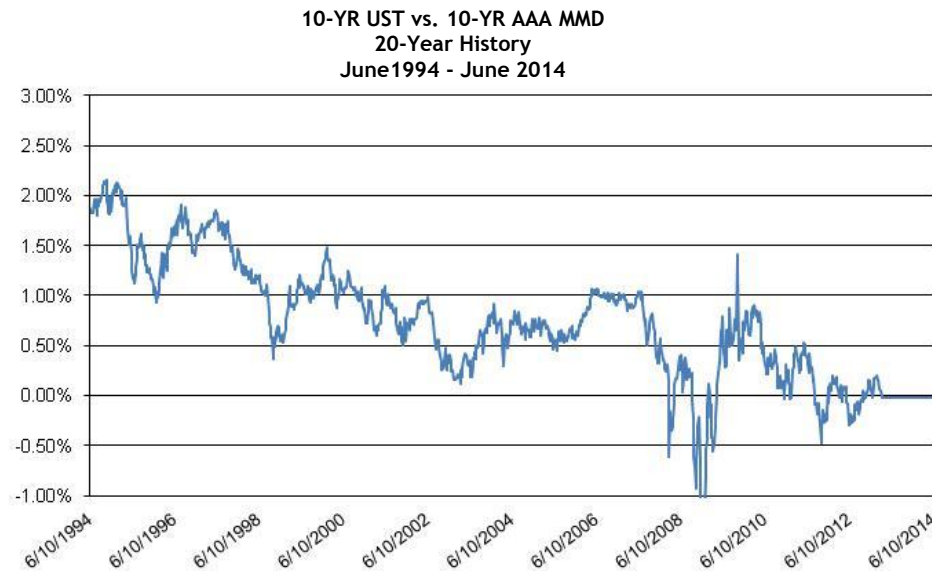
TAX-EXEMPT FINANCING OVERVIEW, CONT'D



- Up to 100% of the project can be financed although many projects will have an equity component
- Bonds can be issued at a fixed or variable rate
- Bonds can be secured by:
 - ✓ Borrower's own credit
 - ✓ Project revenue structure
 - ✓ Credit enhancement to obtain a higher credit rating or to provide liquidity in the case of variable rate demand bonds
- Bonds can be privately placed
- Some projects with low or no credit ratings may require a “qualified investor” letter provided by an underwriter and may have bonds denominated in large amounts

TAX-EXEMPT VS. TAXABLE BONDS

- Tax-exempt bonds are exempt from federal tax and sometimes state income tax
 - ✓ Often translates to lower cost of interest for issuer
 - ✓ However, private activity bonds may be subject to AMT which can increase the interest cost
 - ✓ Historically, spread between AAA tax-exempt and AAA taxable has exceeded 1 percentage but currently, there is little to no spread between the two



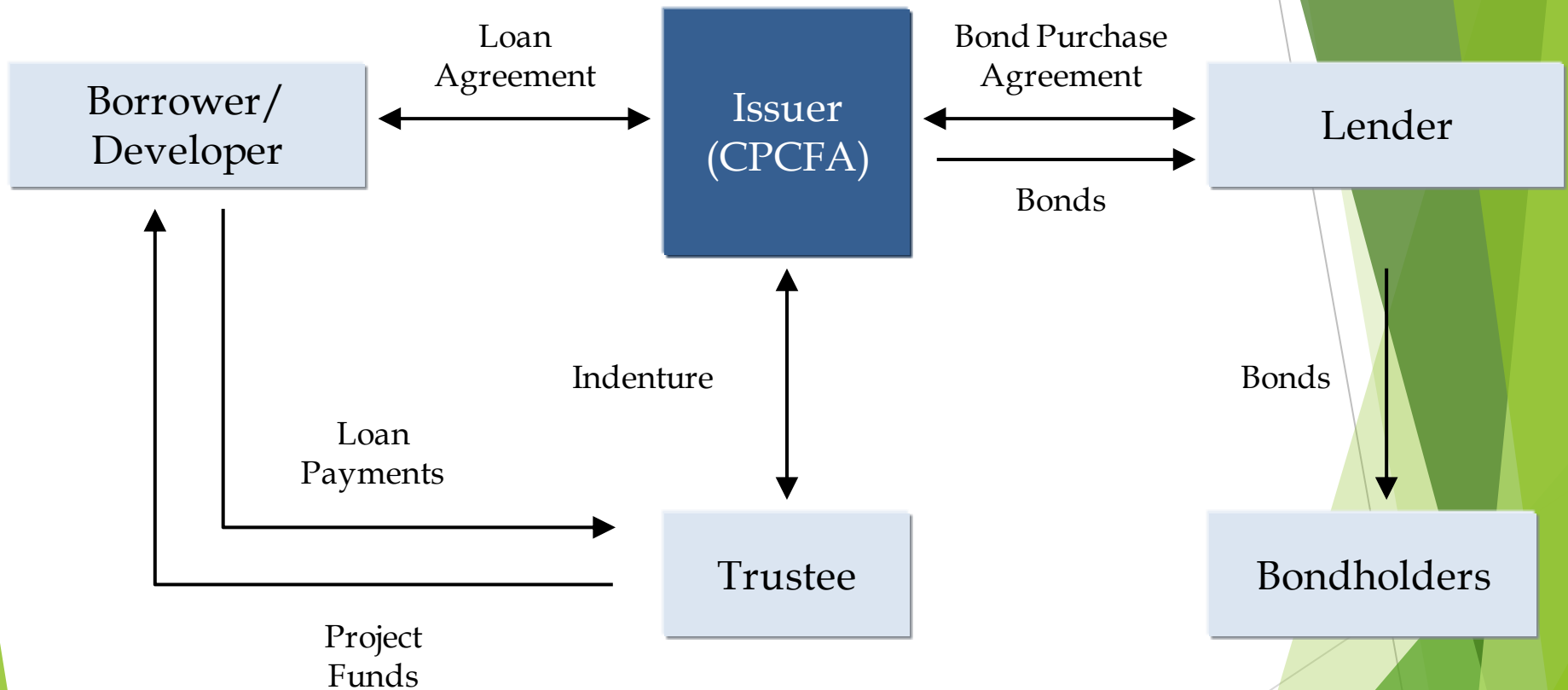
CONDUIT FINANCING

CONDUIT TAX-EXEMPT FINANCING GENERAL REQUIREMENTS



- There are complex tax rules governing the use of tax-exempt financing by private entities
 - ✓ The IRS establishes the eligibility of projects and use of proceeds which may change from year to year
- 95% of bond proceeds must be allocated to capital costs associated with the project
- Borrower must obtain a state volume cap allocation
 - ✓ IRS limits the volume of tax-exempt financing
- Bonds must obtain public approval through an approving body at a TEFRA hearing

TYPICAL BOND STRUCTURE



ROLE OF THE CONDUIT ISSUER

Non-paying agent

- The bonds issued by CPCFA are payable solely by the underlying borrower from the funds and assets pledged for each individual bond issued

Nominal Issuer

- Conduit issuers such as CPCFA convey tax-exempt status and act as a nominal issuer of bonds

Issuer Responsibilities

- Allocation, monitoring and carryforward of volume cap
- Facilitate public approval via a TEFRA hearing
- In some cases, provide access to grants or other financial incentives

PROJECT CASE STUDIES

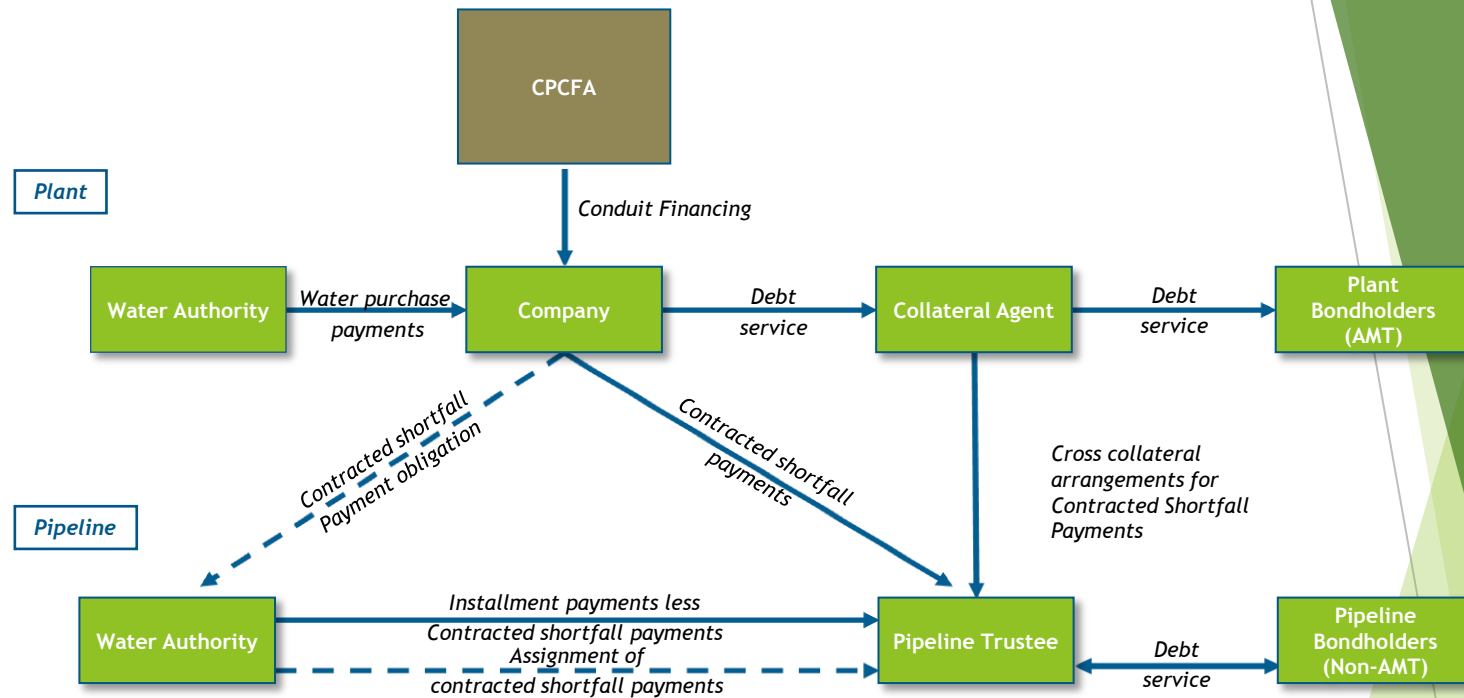
CARLSBAD DESALINATION PROJECT



Public-private partnership between the San Diego County Water Authority (the “Water Authority”) and Poseidon Resources

- Poseidon Resources approached CPCFA for access to non-AMT tax-exempt bond financing
- A portion of the total bond issuance was subject to AMT
- Approximately \$735M bond issuance (\$203M of total issued by SDCWA)
- Reverse osmosis desalination project for 56,000 acre-feet per year for 9 water districts
- Designed and constructed under a lump-sum, turnkey EPC contract
- Plant water will be delivered via a new 10-mile pipeline that connects to existing Water Authority aqueducts
- Take-if-delivered Water Purchase Agreement with the Water Authority for 30 years after completion

Carlsbad Project Financing Structure



San Diego County Water Authority ("Water Authority")

- Organized in June 1944 for the primary purpose of supplying water to San Diego County for wholesale distribution to its member agencies
- Comprised of 24 member agencies, serves 3.2 million individuals
- Imports 70% of its water supply from other sources
 - Supply constraints and increasing demand necessitated further steps to diversify the Region's water supply

Poseidon Water LLC ("Company")

- Private company, specializes in water infrastructure development, investment, and management
- Develops and invests in water supply projects
 - Tampa Bay Desalination (Florida)** - 25 MGD desalination facility
 - Cranston Wastewater Treatment (Rhode Island)** - First large-scale wastewater treatment privatization / upgrade in the U.S.

CARLSBAD PROJECT FINANCING

- Proposed debt is fully amortizing, providing nearly 33 year fixed rate debt
- Adequate protection to investors at the investment grade level
 - ✓ Restrictions on equity distributions prior to achieving stable operation and in the event of a power plant shutdown
 - ✓ Coverage of 1.25x forward and backward looking equity distribution test (1.35x for the first distribution)
 - ✓ 1.35x additional bonds test for discretionary purposes
- Discretionary additional bonds are also subject to Water Authority approval
- Initial net debt/ cash flow available for debt service (CFADS) is elevated at 10x (plant bonds) and 14x (plant and pipeline bonds) in the first full year of operations (2017), which is manageable if the project is operating at targeted performance levels
- The rating case average Debt-Service Coverage Ratio of 1.47x indicates the project can withstand significant stress from delayed start-up, and sub-standard output and operating performance, to electricity consumption and O&M costs
- The plant bonds are secured by net revenues from plant operations
- The pipeline bonds are secured by installment payments by SDCWA, net of any amounts owed by Poseidon as Contracted Shortfall Payments for Poseidon's failure to meet minimum delivery requirements of product water
- Furthermore, the deal incorporated an “Investor Representation Letter”, which required a certification that the investors reasonably meet the standards of a Sophisticated Investor or Qualified Institutional Buyer, and that they have the sophistication to evaluate the merits and risks of the investment



TRANSACTION SUMMARY

Key Terms	Series 2012 Plant Bonds (AMT) & Series 2012 Pipeline Bonds (Non-AMT)	
Issuer	California Pollution Control Financing Authority	
Obligor	<ul style="list-style-type: none">■ Poseidon Resources (Channelside) LP■ San Diego County Water Authority	
Par Amount	<ul style="list-style-type: none">■ \$530,345,000 (Plant Bonds)■ \$203,215,000 (Pipeline Bonds)	
Use of Funds	<ul style="list-style-type: none">■ Pay a portion of the anticipated costs of constructing the Plant and Pipeline	
Tax Status	<ul style="list-style-type: none">■ Federal and State of California tax-exempt■ Subject to the AMT/Not subject to the AMT	
Bond Structure	<ul style="list-style-type: none">■ Current interest bonds maturing from 07/01/2027 to 11/21/2045	
Optional Redemption	<ul style="list-style-type: none">■ 10-Year Par Call Anticipated■ 5-Year Par Call Anticipated	
Expected Ratings	Moody's: Baa3	Fitch: BBB-
Closing Date	Thursday, December 24, 2012	

CPCFA's BENEFITS TO THE CARLSBAD PROJECT



Cost of Financing

- The Water Authority and Poseidon were able to achieve lower interest rates on financing due to the AMT exemption provided by the tax-exempt status of the bonds

Risk Transfer

- Unlike municipal bonds that also carry T/E status, Poseidon will solely be at risk to pay the principal and interest on the private activity bonds
- State of California and SDCWA customers bear no financial responsibility for the repayment of bonds

Benefits to Ratepayers

- The allocation of private activity bonds should lower debt service costs, which in turn, allows customers to purchase water at a lower rate
- Lower cost of new drinking water supply for San Diego ratepayers

**Awarded “North American Water Deal of the Year 2012” by
*Project Finance Magazine***

Bay Counties Waste Services, Inc.



- The Company provides solid waste, recycling and disposal services for homes, businesses, and industries for the cities of Sunnyvale, Mountain View and Palo Alto.
- The Company was awarded a new contract to operate an existing Material Recovery Facility and Transfer Station.
- In order to meet its contractual obligations, the Company needed additional equipment to service the anticipated waste volume.
- CPCFA issued \$8,820,000 in tax-exempt bonds to finance the acquisition of solid waste processing equipment such as containers, conveyors, sorters, rolling stock and related equipment.
- Since the Company is a small business, they were eligible for assistance from the Small Business Assistance Fund. The Company received \$118,320 to offset certain costs of issuance.



TRANSACTION SUMMARY

Key Terms	Bay Counties Smart Project Series 2014
Issuer	California Pollution Control Financing Authority
Obligor	■ Bay Counties Waste Services, Inc.
Par Amount	■ \$8,820,000
Use of Funds	■ Purchase of containers, conveyors, sorters, rolling stock and related equipment.
Tax Status	■ Federal and State of California tax-exempt
Bond Structure	■ Weekly variable rate maturing 08/31/2034
Rating or Credit Enhancement	■ Credit Enhancement
Closing Date	October 15, 2014

Collateral Support Example: UC Davis Anaerobic Digester



Early commercialization phase \$10 million project

Company expected \$5 million government supported loan, but needed to break ground many months ahead of USDA guarantee

Bank wanted to provide bridge loan, but company short on collateral due to early commercialization phase

CPCFA provided \$2 million cash on deposit as collateral for \$5 million loan, making bank loan possible

CAEATFA provided a sales tax exclusion of almost \$500,000 for \$5.8 million in eligible equipment

Project now operational

Collateral Support Example: Feed Pellet/Bio-Fuels Manufacturing



Company converts waste product (shells) from almonds, pistachios and walnuts into new feed for livestock.

Company is also making inroads into Asian markets with fuel pellets as an alternative source of energy.

Additional working capital will allow flexibility to purchase more waste material when prices are seasonally low thus increasing profits and volume.

Bank wanted to provide bridge loan, but loan to value was too high and had insufficient collateral to off-set.

CPCFA will provide collateral support of \$875,000 or 50% of the total loan making bank loan possible.

